

Memorandum

To : Honorable Jerome Horton, Chairman
Honorable Michelle Steel, Vice Chair
Honorable Betty T. Yee, First District
Senator George Runner (Ret.), Second District
Honorable John Chiang, State Controller

Date: November 1, 2011

From : Jeffrey L. McGuire, Deputy Director
Sales and Use Tax Department (MIC 43)

Todd C. Gilman, Chief
Taxpayers' Rights and Equal Employment Opportunity
Division (MIC 70)

Subject : Suggestion to Provide Guidance on Standard of
Proof Regarding Sales and Use Tax Matters

At the September 20, 2011 Taxpayers' Bill of Rights Hearings and in subsequent correspondence, Mr. Jesse McClellan, McClellan Davis, LLC, suggested that the Sales and Use Tax Department provide guidance on the standard of proof applicable to sales and use tax matters. Mr. McClellan cited Evidence Code section 115 as well as several court cases, and stated different standards of proof are being applied by different district offices, and in some cases, by different auditors within the same district office, thereby creating inconsistency in the audit program and in the administration of tax in general. To resolve this alleged inconsistency, it was suggested that Regulation 1698.5, *Audit Procedures*, be amended to incorporate guidelines for determining and applying a preponderance of evidence standard; and that a detailed discussion of a preponderance standard be provided in Audit Manual Chapter 4, *General Audit Procedures*. A copy of Mr. McClellan's October 4, 2011 correspondence is attached.

We believe there is no basis for this assertion and do not agree that the regulation should be amended or that any extensive changes be incorporated into the Audit Manual. We believe that staff is correctly applying the appropriate burden of proof in tax matters before this Agency.

Revenue and Taxation Code section 6091 provides that it shall be presumed that all gross receipts are subject to the tax until the contrary is established. A taxpayer can rebut this presumption by a preponderance of the evidence. For cases not involving civil tax fraud, the Board of Equalization (BOE) applies the preponderance of evidence standard of proof. This is the burden of proof as specified by Evidence Code section 115. The preponderance of the

evidence standard of proof is also applied by the courts in sales and use tax matters not involving civil tax fraud. (See *Maganini v. Quinn* (1950) 99 Cal. App. 2d 1, 7-8, and *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal. App. 3d 739, 748-749).

It is the Sales and Use Tax Department's (SUTD) policy to perform audits in an efficient and professional manner, including adhering to a preponderance of evidence standard of proof. To this end, the SUTD has a strong commitment to properly train the audit staff. The audit staff receives numerous hours of formal classroom training on sales and use tax law, as well as auditing procedures, methods and statistical sampling. Although the auditing approach is standardized, each auditor has the flexibility to use methods and procedures appropriate for the type of business under audit and the records available. Further, once an audit is completed there are several levels of review. The audit supervisor and the district reviewer monitor the auditor's work and evaluate the accuracy of the completed audit. Further, there are additional safeguards to ensure proper judgment on these matters, including the administrative appeals process.

The SUTD's audit program, including comprehensive training, supervision, and review, results in audits that comply with the burden of proof specified by Evidence Code section 115 and the court cases cited above. Nevertheless, we recommend adding a statement to the Audit Manual that says that, in the case of non-fraud cases, the taxpayer's burden of proof is the preponderance of evidence when the taxpayer is rebutting the presumption in section 6091. The statement would clarify that "preponderance of evidence" relates to the probability of truth, and can be defined as, "such evidence as, when weighed with that opposed to it, has more convincing force and the greater probability of truth"¹ and "more likely to be true than not true."² We believe this change to the Audit Manual is a sufficient clarification and that there is no need for a regulatory amendment.

If you need additional information or have any questions, please contact Jeffrey L. McGuire at (916) 445-1441 or Todd C. Gilman at (916) 324-2796.

JLM/TCG:dmt

cc: (with attachment)
Ms. Regina Evans, Board Member's Office, Fourth District
Mr. Louis Barnett, Board Member's Office, Third District
Mr. Alan LoFaso, Board Member's Office, First District
Mr. Sean Wallentine, Board Member's Office, Second District
Ms. Marcy Jo Mandel, Deputy Controller
Ms. Kristine Cazadd (MIC 73)
Mr. Randy Ferris (MIC 82)
Ms. Christine Bisauta (MIC 82)
Mr. Stephen Rudd (MIC 46)
Mr. Kevin Hanks (MIC 49)
Ms. Susanne Buehler (MIC 92)

¹ Witkin, Cal. Evidence (4th ed. 2010) Burden, § 35.

² Jury instruction. (CACI 200.)



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TAX POLICY DIVISION

Memorandum

To: Todd Gilman, Chief, Taxpayers' Rights Office

Date: October 4, 2011

From: Jesse McClellan, McClellan Davis, LLC

Subject: Suggestion to provide guidance on the standard of proof

As you are aware, at the recent Taxpayers' Bill of Rights Hearings held in Sacramento on September 20, 2011, I raised an issue regarding the standard of proof which is applicable to sales and use tax matters. We believe guidance on the standard of proof should be provided by regulation and also included in the audit manual. We are requesting that the Advocate's Office work with the Sales and Use Tax Department in developing policy.

Analysis

In relevant part, Evidence Code section 115 provides, "Except as otherwise provided by law, the burden of proof requires proof by a preponderance of the evidence." Otherwise provided by "law" has been interpreted as meaning California constitutional, statutory, and decisional law. (Cal. Evid. Code. § 160; *Cal. State Bd. of Equalization v. Renovizor's Inc.* (2002 9th Cir.) 282 F.3d 1233, 1239-1240.) There is no known "law" which provides for a different standard of proof for sales and use tax matters. The authority cited below appears to make this point clear.

"The general rule in this state is that issues of fact in civil cases are determined by a preponderance of testimony." (*Weiner v. Fleischman* (1991) 54 Cal.3d 476, 483.) "Because no "law" requires that a standard of proof other than preponderance of the evidence be applied in administrative proceedings to suspend or revoke a food processor's license, § 115 governs the standard of proof in proceedings to revoke or suspend a food processor's license." (*San Benito Foods v. Veneman* (1996) 50 Cal.App.4th 1889, 1894-1895.) "In civil cases (whether in court or in agencies), the burden of [proof] generally requires the proponent to prove the case by a preponderance of the evidence." (Asimow & Cohen, *Cal. Administrative Law* (2002) § 3.4, pp 88-89.)

"It does not make sense that citizens of California could be served by one standard in the courts and another in administrative agencies." (*Cal. State Bd. of Equalization v. Renovizor's Inc.* (2002 9th Cir.) 282 F.3d 1233, 1240.)

With the exception of cases for fraud and certain professional license revocation proceedings, it is well established that the standard of proof for resolving factual issues in civil matters is proof by a preponderance of the evidence. The Board of Equalization has promulgated the preponderance standard for property tax matters under Property Tax Rules, Rule 321, *Burden of Proof*. As it pertains to sales and use tax fraud, the applicable clear and convincing standard can be found in Regulation 1703 subdivision (c)(3)(C), with thorough explanatory guidelines provided in Chapter 5 of the Audit Manual. However, the preponderance of the evidence standard is not found in any sales and use tax regulation or audit manual section.

It has become apparent that different standards of proof are being applied by different district offices, and, in some instances, by different auditors within the same district, thereby creating inconsistency in the audit program and in the administration of tax in general.

It is reasonable to believe that providing guidelines for the standard of proof will significantly increase consistency in the resolution of factual issues. Such increased consistency, in turn, can reasonably be expected to reduce the number and complexity of fact-based protest cases. At this time, there are no known guidelines for determining "preponderance of the evidence" that are available to Board auditors and other Board personnel within the general resources relied upon for sales and use tax purposes, i.e. regulations, manuals or operations memorandums.

Regulation 1698.5, *Audit Procedures*, already provides a broad spectrum of guidance regarding audit procedures. Accordingly, it appears that Regulation 1698.5 would be an appropriate vehicle in which to incorporate guidelines for determining and applying the preponderance standard. It is also suggested that a detailed discussion of the preponderance standard be incorporated into Audit Manual Chapter 4, "General Audit Procedures."

We welcome any comments or questions regarding this issue. I can be reached at the above address, by telephone at (916) 737-5637 or by email at jesse@md-astc.com.

Cc: Honorable Jerome E. Horton, Chairman
Honorable Michelle Steel, Vice Chair
Honorable Betty T. Yee, Board Member, First District
Senator George Runner, Board Member, Second District
Honorable John Chiang, State Controller
Marcy Jo Mandel, Deputy State Controller
Kristine Cazadd, Executive Director
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Jeffrey McGuire, Deputy Director, Sales and Use Tax Department
✓ Susanne Buehler, Chief, Tax Policy Division
Laureen Simpson, Taxpayers' Rights Advocate Office